THE FIRST FIVE YEARS

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THE HOME OWNERSHIP OPTION FOR
LOW INCOME FAMILIES

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Third Evaluation Report on the
Department of Planning and Housing Victoria
Capital Indexed Loan (Capil) Scheme

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for the
Department of Planning and Housing Victoria
This booklet summarizes the results of the Australian Institute of Family Studies' Third (and final) Evaluation Report to the Department of Planning and Housing Victoria on the Capital Indexed Loan Scheme. This study has been a five-year research project following the progress of the original families to receive a Capil loan. The study was funded by the Department of Planning and Housing Victoria.

The author acknowledges the assistance of Viviana Lucchesi in the preparation of this summary, and of Andrew Beer in the development and analysis of the economic model of housing benefits.
BACKGROUND

In early 1985, 481 families became the first participants in a new home loan scheme offered by the then Victorian Ministry of Housing and Construction, the Capital Indexed Loan Scheme. This Scheme was set up in 1984 to address the housing needs of families on limited incomes, single earner families, sole parents, and families reliant on government pensions or benefits. Given the high cost of housing finance, these families were virtually excluded from home purchase. Apart from the existing public tenants, others faced either delays of up to several years for public rental accommodation, or private rental payments that drained large proportions of family budgets. Moreover, these families held strongly the Australian ethos of home ownership, however unrealistic that dream was on their limited incomes. The Great Australian Dream seemed permanently out of reach.

By offering capital indexed loans, the Department aimed to provide families with an affordable alternative to conventional loan arrangements. The loan arrangement is called a capital indexed loan because the capital owed is indexed by the Consumer Price Index, against which a 3 per cent per annum real interest rate is charged.
Repayments under the Capital Indexed Loan Scheme are based on 25 per cent of gross family income and are designed to remain constant in real terms over the period of the loan. Families may also adjust their repayments in line with any changes in income, to maintain their repayments at 25 per cent of income.

AIFS Capil Evaluation Project

This report summarises the final results of the five-year Capital Indexed Loan Evaluation Study conducted by the Australian Institute of Family Studies on behalf of the Department of Planning and Housing Victoria.

The study consists of a series of three personal interviews with families who received Capital Indexed Loans. These families were first interviewed shortly after they moved into their new homes in late 1985 to early 1986, and were visited again 18 to 24 months later in October-November 1987. The third and final interview took place during July-August 1989.

This longitudinal study design has been extremely valuable in charting the outcomes of home purchase for families. By re-visiting families nearly five years after moving into their new homes, this study offers a far more reliable picture of the effects of home purchase than would a single interview conducted in the early 'honeymoon' phase of home ownership.

The original study design included a control group of 275 families renting in either the public or private sector. Families in this group were similar to the Capil families in terms of family income, size, and family
type. This design was intended to separate the effects of home purchase per se from characteristics of families themselves on housing attitudes and other social and economic behaviours.

During the first two rounds of interviews this exercise provided valuable information on contrasts and similarities between families in the Capil Scheme and comparable families who rented their accommodation.

Between the first and second interview, however, over 100 renter families dropped out of the study. This meant that only 167 renters remained in the study, raising questions about their representativeness. The Institute therefore decided not to interview renters at the third round given that there was likely to be a further sample loss.
The focus of the third round of interviews then is on the Capil families themselves. But in a study such as this, spanning nearly five years, the number of families available to be interviewed at each stage inevitably declines. Some lose interest in being interviewed further; others could not be contacted for interview; and, in this particular study, a few had sold their homes and were no longer part of the Scheme. This latter reason accounted for 78 of the 116 families who participated in the first interview, but were not available for either the second and/or third interviews.

According to information collected at the second interview, families who left the Scheme tended to be younger, better placed financially and educationally, and more likely to be married, than those who remained. This suggests that families who discharged their mortgage and subsequently left the Scheme did not do so out of an inability to afford their housing, but because they desired a better house or a different neighbourhood.

Twelve families who had left the Scheme were available for a personal interview. Discussions with these families indicated they moved for the usual reasons families move — they needed more space for their growing family or they preferred a different location. All were in the process of purchasing another home and nearly all felt the Capil Scheme had been definitely worthwhile for themselves and their families. Some typical comments were:

'We have our fourth child on the way and this is a two-bedroom house.'
'I remarried. We’re building a larger house.'

'It is definitely worthwhile as we have made some profit from selling the house. I did not have to pay rent these several years, and it gave us the sense of freedom, security, and achievement to own a house.'

Overall, the selective nature of the families leaving the study has meant the remaining respondents generally had a lower educational and income level than would have been the case if all 481 Capil families had continued on through three rounds of interviews. But an important point to note is that most people who left the Scheme were not dissatisfied with Capil or unable to afford home purchase, but rather were acting on preference for a larger or better home.

**Aims of the Third Evaluation Study**

The central issues of this Third Evaluation Report are:

- Does the Scheme provide affordable repayments?

- Does home ownership pose too heavy a financial burden in terms of other housing costs, such as home repairs and improvements?

- Do families increase their income and employment over time allowing them to keep up with indexed repayments?

- What level of equity have families accrued in their homes?
• What is the total financial benefit received by families in the Capital Indexed Loan Scheme?

• Do families understand the Scheme and feel satisfied with their home purchase under a capital indexed mortgage?

In contrast to the previous two interviews conducted in the honeymoon and settling in phases, these issues reflect the fact that after more than four years these families were established home purchasers.
KEY FINDINGS

Housing Affordability

Technically, repayments on the Capil loan are geared to 25 per cent of family income. But the pattern noted in the Second Evaluation Report — that of very few families paying the expected amount and most paying considerably less — persisted through the third interview. Repayments consumed on average 24 per cent of net family income, although the additional costs of rates and house insurance raised this proportion to 28.1 per cent.

As shown in Table 1, over two-fifths of those interviewed were repaying amounts less than 20 per cent of net family income. On the other hand, 16 per cent paid more than 30 per cent. And, while in 1987 at the time of the second interview, 32 per cent paid less than 20 per cent of net income on repayments, this figure increased to 42 per cent by the third interview in 1989.

Under the terms of the Capital Indexed Loan Scheme, families can personally re-adjust the amount they repay
Table 1: Mortgage repayments as a per cent of family income

<table>
<thead>
<tr>
<th>Mortgage as per cent of income</th>
<th>1985-86 Stage 1 (net)</th>
<th>1987 Stage 2 (net)</th>
<th>1989 Stage 3 (net)</th>
<th>1989 Stage 3 (gross)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-15</td>
<td>6.9</td>
<td>14.6</td>
<td>19.4</td>
<td>28.3</td>
</tr>
<tr>
<td>16-20</td>
<td>16.1</td>
<td>17.4</td>
<td>23.1</td>
<td>24.2</td>
</tr>
<tr>
<td>21-25</td>
<td>39.4</td>
<td>31.4</td>
<td>25.3</td>
<td>21.1</td>
</tr>
<tr>
<td>26-30</td>
<td>27.8</td>
<td>20.7</td>
<td>16.1</td>
<td>16.1</td>
</tr>
<tr>
<td>31 or more</td>
<td>9.7</td>
<td>16.0</td>
<td>16.1</td>
<td>10.0</td>
</tr>
</tbody>
</table>

The Department to reflect any real changes in their household income. Approximately 45 per cent took up this option, of whom 85 per cent increased the amount they repaid and 15 per cent decreased.

The other 55 per cent left their repayment at the same level except for the automatic Department adjustment for inflation. The following are typical responses to the question of why this group had not personally made any adjustment, and may give some insight into why so many families are repaying less than the required amount to the Department.

'We can't afford to pay any more. We need the cash for improvements.'

'I'd like to, but basically the cost of living has gone up.'

'I pay all I can at the moment.'
However, 38 per cent of families had increased the amount they were paying, mainly because they wished to pay off the loan more quickly:

'We want to try and get ahead.'

'We're paying more so we can reduce the interest and pay off the debt quickly.'

Twenty-five families had actually decreased the amount they were paying the Department. These families were among the lowest income earners in the group and had typically lost real income between the second and third interviews. As one respondent commented:

'When I changed jobs and got less money, the Department reassessed my payments and reduced them.'

Because Capil repayments are limited to 25 per cent of gross family income, it was not surprising that repayments were significantly related to family income. But, in addition, marital status and employment status had an independent effect on the amount repaid, with married people and those in employment making relatively higher repayments than others, irrespective of the level of family income.

Overall, only 35 families (approximately 10 per cent) said they had an arrears agreement with the Department. This is the same proportion that had an arrears agreement at the second interview in 1987. The two factors most related to being in arrears were low family income and marital disruption. Twenty per cent of people in arrears had been separated or divorced.
since the previous interview compared with very few of those not in arrears.

Home Repairs and Improvements

Sixty-eight per cent of families reported carrying out major repairs and improvements to their homes: 211 families reported discretionary home improvements, mainly painting or renovating a kitchen or bathroom; 110 families reported work defined as basic or structural, the most common being repairs to the roof. The median cost of this work added between 9 to 12 per cent to monthly housing expenditure.

Almost all the families involved themselves physically in carrying out this work. As Figure 1 shows, only 7
per cent said they hired tradesmen to do the work and over half reported having done nearly all the work themselves.

The majority of families reported that they enjoyed or loved working on their homes. When asked approximately how much of the repairs and renovation work could be described as 'necessary', only 23 per cent said that all the work was necessary, and 31 per cent stated that none of the work was necessary. Families generally reported that they felt this work improved the value of their dwellings.
Employment and Income

In 1985, when the Institute's evaluation of the Scheme began, only one-quarter of Capil respondents were in paid employment. Since that time, there have been steady gains in the proportion of adults in the paid labour force. This improved employment picture has helped maintain the capacity of families to meet their mortgage repayments. Because these repayments are indexed to the Consumer Price Index, family income needs to keep pace with inflation if repayments are to remain constant in real terms.

For married couples, the general trend has been to enter the workforce, and by the third interview 30 per cent of couples had become two-income households (Figure 2).

Figure 2: Employment profile of two-parent families at each stage (N=155)
Figure 3 shows that the 141 female sole parents also increased their labour force participation, with more than one-quarter in full-time employment by the time of the third interview; others had found some part-time work, half of whom described their work as regular, while others said it was casual or temporary.

Figure 3: Employment profile of sole parents at each stage (N=141)

Reasons given for not being in paid employment were varied. Two-thirds of men reported poor health as the major reason for not being in the labour force. Likewise, married women said poor health prevented them from entering paid employment. On the other hand, most female sole parents reported the needs of their children as the major barrier to workforce participation, although many also mentioned ill health. Given the overall predominance of health-related reasons, particularly among the married couples, it may be the case that the employment level of this group has nearly reached its peak.
As a general benchmark of income trends, Table 2 examines the extent to which Capil family incomes kept pace with full-time, male average weekly earnings. As indicated, there has been a gradual increase over time in the proportion of families with incomes exceeding three-quarters of average weekly earnings. At the first interview, less than 5 per cent had incomes at this level compared with 24 per cent at the third interview. Moreover, the proportion of families with incomes of less than half average weekly earnings fell from nearly two-thirds to just under one-third between the first and final interviews.

<table>
<thead>
<tr>
<th>Proportion of Average Weekly Earnings</th>
<th>Stage 1 1985-86</th>
<th>Stage 2 1987</th>
<th>Stage 3 1989</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-25</td>
<td>1.7</td>
<td>3.6</td>
<td>3.9</td>
</tr>
<tr>
<td>26-50</td>
<td>62.9</td>
<td>44.6</td>
<td>31.6</td>
</tr>
<tr>
<td>51-75</td>
<td>30.5</td>
<td>33.7</td>
<td>40.7</td>
</tr>
<tr>
<td>76-100</td>
<td>3.4</td>
<td>9.5</td>
<td>13.6</td>
</tr>
<tr>
<td>101-150</td>
<td>1.4</td>
<td>8.1</td>
<td>10.0</td>
</tr>
<tr>
<td>151 or more</td>
<td>0.0</td>
<td>0.6</td>
<td>0.3</td>
</tr>
<tr>
<td>Mean</td>
<td>49.3</td>
<td>58.8</td>
<td>63.1</td>
</tr>
<tr>
<td>Median</td>
<td>47.7</td>
<td>53.0</td>
<td>56.5</td>
</tr>
</tbody>
</table>

Nonetheless, the median net family income at the third interview reached only 56 per cent of average weekly earnings, not dramatically up from 47 per cent at the original interview. Despite the encouraging increases in employment, average incomes remained modest.
Nominal Equity Five Years Later

In contrast to renting, home purchase has given Capil families the opportunity to gain equity in a property. At the time of Capil purchase, the Melbourne housing market was just beginning to recover from a six-year decline in real house prices. From 1985 to 1989, Melbourne's house prices increased in real terms by around 7.7 per cent per annum.

In order to investigate the nominal equity accrued by each Capil family, independent licensed valuers assessed each property and provided approximate market values as of 1 July 1989.

Figure 4 illustrates how the value of Capil homes rose unevenly across locations. Because of ceilings on the purchase price imposed under the Scheme — generally 20 to 25 per cent lower than the median house price at
that time — families originally paid approximately the same amounts for their dwellings, regardless of where they purchased. Across the Melbourne metropolitan area, families spent an average of $53,000, while outside Melbourne the average purchase price was $47,000.

Families’ decisions about where to live in 1985 led to an unequal distribution of the capital gains associated with home purchase. Simply by virtue of their original locational decisions, the value of some dwellings increased tremendously relative to others.

In nominal terms, Capil dwellings purchased in inner Melbourne nearly doubled in value between 1985 and 1989. In areas outside metropolitan Melbourne, these homes increased by 60 per cent. The value of all dwellings, regardless of location, kept well ahead of inflation. Properties in the inner area of Melbourne outstripped inflation by 40 per cent, while outer and fringe areas were 20 to 25 per cent ahead of inflation.

When the outstanding debt to the Department of Housing and Construction was taken into account, families in the Scheme had accrued an average equity of $40,000. Many respondents were either unaware of or underestimated their equity position, mainly due to lack of knowledge about the market value of their homes. Twenty per cent of respondents underestimated their equity by more than $15,000 and another 15 per cent reported not knowing the equity of their home.
An Economic Model of Financial Benefit

Home purchasers receive financial benefits and encounter expenses not borne by those in the rental sector. To start with, they are confronted with the transaction charges on their purchase. Thereafter, they regularly face mortgage interest costs, local government and water rates, and maintenance expenses. Against this, of course, must be balanced the financial benefits: an appreciating capital asset; the advantages conveyed by the taxation system (imputed rent); and enforced savings earned through the repayment of capital. In brief, the financial benefits of home purchase are more complex than simple nominal equity might suggest.

For these reasons, a comprehensive economic model of housing benefits under Capil was developed. This model was used to estimate the financial outcome after five years, project the likely financial outcome over a 25-year period, and compare the operation of the indexed loan structure with other financial instruments, particularly credit-foncier, over the short- and long-term scenarios.

Using this model, the median accrued financial benefit under Capil after the first five years was $32,874.

Under a credit-foncier scenario reflecting the standard loan available at the time from private sector institutions, interest rates would have been higher and repayments larger in the first five years than the 25 per cent of income required of Capil borrowers. The average financial gain would have been 70 per cent ($21,166) of that acquired under Capil. The principal
sources of financial gains for households participating in the Scheme were the rapid escalation in house prices over the period of the Institute study (this would have been experienced by all home purchasers regardless of type of financing), the low interest repayments relative to the imputed rental value of dwellings, and the repayment of capital.

In the 25-year projection, these latter two factors continued to enhance the financial position of those participating in the Scheme compared with the credit-foncier scenario. In terms of financial gains, Capil was still 30 per cent ahead with a benefit of $103,546 compared with $72,589 under a 13.5 per cent regulated loan. The low average annual interest rate of approximately 10 per cent offered to clients in the Capil Scheme adds considerably to their financial benefit.
Attitudes Towards Home Purchase

On the whole, families viewed the benefits of home purchase not in the abstract terms of economic models, but in a highly personal manner. Purchasing a home of their own was highly valued by families, mainly for the security, stability and sense of pride it offered. More than nine out of ten families reported that home purchase had been 'definitely worthwhile'. The following are typical responses describing home ownership:

'Home ownership, security, independence from rental rogues, a feeling of pride and stability ... we like it here.'

'My children are more secure. There's an improved outlook in the family, more personal pride.'
'You've got your own roof, own backyard, privacy, somewhere to park your car. We made a good investment.'

'We would never have had a house without this loan. It makes us feel secure.'

Only 11 families thought home purchase was not worthwhile. Of these, eight said that the loan was too great a financial burden, while the others either disliked the location, the fact they paid rates, or the costs of meeting repairs:

'I was better off in the flat. In a house, you really have to be working to keep up the payments. You have to have a good income to pay for a house and other costs.'

'Owning a home is more responsibility financially. You have to keep up with the payment.'

If satisfaction with the Scheme is viewed in terms of whether families wish to vote with their feet, 79 per cent of families reported that they had no intention of moving:

'Why move? Where would I stay? They'll have to cart me out in a wooden box. I like it here. My daughter loves it here.'

'I'm happy with the house.'

'I'm happy with it. I'd renovate rather than sell it. I like the house. I like the area a lot.'
Of those who planned to move, almost all gave reasons related to the location or dwelling rather than the Capil Scheme itself.

Understanding the Capital Indexed Loan

When introduced by the Victorian Ministry of Housing and Construction in 1984, indexed loans were an innovative (indeed, groundbreaking) alternative to conventional credit-foncier mortgages. One consequence of this is that even by 1989 most families did not fully understand how their mortgage instrument actually operated. There were difficulties in understanding how interest was calculated, why the
loan was indexed to the Consumer Price Index, and why the nominal outstanding balance kept increasing.

Most families wished for a different kind of mortgage instrument — one with a fixed interest rate and an outstanding balance that appeared to decline. Many failed to appreciate that it was the very structure of the indexed loan which enabled them to purchase a home at affordable levels of repayment.

Considerably more consumer education is necessary if this complex loan structure is to be better understood by the community.
CONCLUSION

During the period of Capil's existence, 5200 Capital Indexed Loans were provided to eligible families. By 1989, because of the real decline in housing funds under the Commonwealth State Housing Agreement, the Department of Planning and Housing Victoria ceased offering these particular loans. Yet the demand on the Department for home purchase assistance is steadily increasing. In order to spread the housing finance dollars further, and at the same time meet the needs of low income families, housing finance for families at a similar economic level to the Capil group now takes the form of Shared Home Ownership. For the slightly higher income group, the Home Opportunity Loans Scheme (a capital indexed loan with a higher real interest rate than Capil) has been introduced.

However, the replacement by other programs of the Capital Indexed Loan Scheme does not negate the broader implications of the Institute's research. Its evaluation study began at a time when state housing authorities, not only in Australia but also in many overseas countries, began shifting policy direction away from an emphasis on public rental towards home purchase. In essence, the Institute study has been about the nature and meaning of home ownership in
Australia and the extent to which home ownership is a viable housing alternative for families on very low incomes.

During the course of this five-year research project, the relatively unexamined taken-for-granted Australian attachment to home ownership has been placed under the social science microscope. By restructuring traditional mortgage lending arrangements, the Department of Planning and Housing Victoria provided many low income families with their only opportunity to buy homes. At the same time, these families were offered the opportunity to participate in the housing tenure of nearly three-quarters of Australian households.
The benefits to families were both financial and personal. Many of the financial benefits were a direct result of the structure of the capital indexed loan instrument, the interest rate subsidy offered under the Capil Scheme, and real house price appreciation during the period under study. But beyond the economic benefits, nearly all Capil families described a highly satisfying living environment, a sense of security not previously experienced, and the freedom, challenge, and hard effort of working on their homes.

The Institute's evaluation study has provided information on the early policy concerns surrounding the introduction of the Capil Scheme. In the context of a changing system of housing provision, there is a continued need to combine evaluation research with innovative housing policies to ensure that responsive and quality housing programs are available to families on limited incomes.
FURTHER REPORTS ON THE CAPIL PROJECT


'Housing for Low Income Families', by Paul Napper in Family Matters: AIFS Newsletter, Number 20, April 1988, page 22.


Home Ownership for Low Income Families: Executive Summary, prepared by Maryann Wulff, Australian


'Housing Low Income Families: Dream Homes or Dilapidated Traps?', by Maryann Wulff in *Family Matters: AIFS Newsletter*, Number 24, August 1989, pages 6–9.


'Low Income Home Ownership: The Privatization of Squalor or the Great Australian Dream?', by Maryann Wulff in *Housing Studies*, July 1990.
